IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 873.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

against

THE NEW YORK TRUST COMPANY, AS TRUSTEE UNDER TRUST INDENTURE, DATED DECEMBER 24, 1921, BY AND BETWEEN CONRAD HENRY MATTHIESSEN AND SAID THE NEW YORK TRUST COMPANY,
Respondent.

No. 899.

THE NEW YORK TRUST COMPANY, AS TRUSTEE UNDER TRUST INDENTURE, DATED DECEMBER 24, 1921, BY AND BETWEEN CONRAD HENRY MATTHIESSEN AND SAID THE NEW YORK TRUST COMPANY,
Petitioner,

against

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT IN No. 873 AND FOR PETITIONER IN No. 899.

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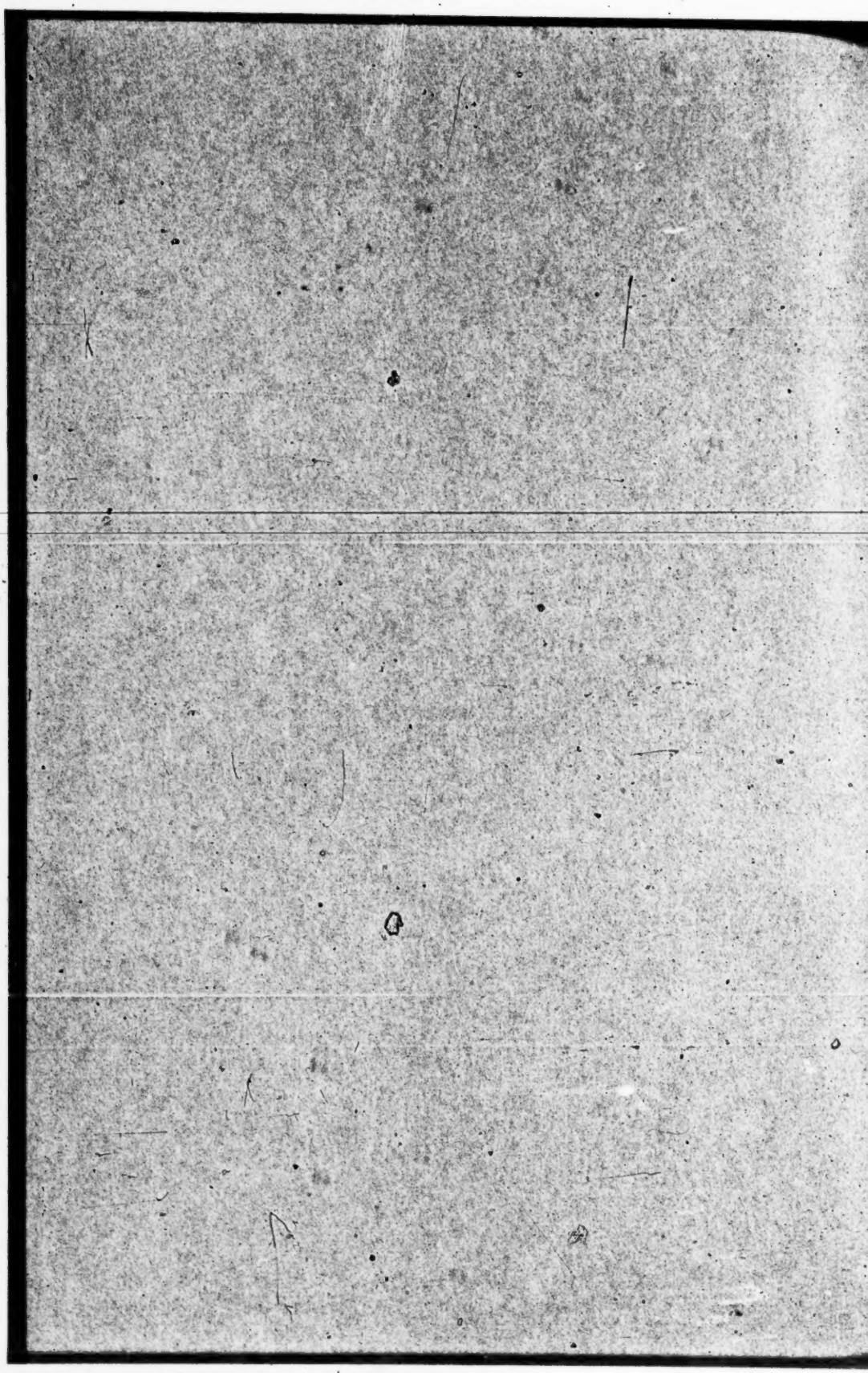

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IN THE

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No. 873

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

AGAINST

THE NEW YORK TRUST COMPANY, as Trustee under Trust Indenture, dated December 24, 1921, by and between Conrad Henry Matthiessen and said The New York Trust Company,
Respondent.

No. 899

THE NEW YORK TRUST COMPANY, as Trustee under Trust Indenture, dated December 24, 1921, by and between Conrad Henry Matthiessen and said The New York Trust Company,
Petitioner,

AGAINST

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT IN No. 873 AND FOR PETITIONER IN No. 899

Opinions Below

The opinion of the Board of Tax Appeals (R., pp. 29-34) is reported in 27 B. T. A. 1127. The opinions

of the Circuit Court (R., pp. 39-42) are reported in 68 F. (2) 19.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered December 26, 1933. Petitions for certiorari were filed March 17, 1934 and March 26, 1934, respectively, and were granted April 9, 1934 (R., p. 45). The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented

In No. 899. Where a trust was created in 1921 for the benefit of the grantor's son, to which was transferred stock purchased by the grantor in 1906, and such stock was sold by the trustee in 1922, what is the basis for computing gain or loss? Specifically, does Sec. 202(a) (2) of the Revenue Act of 1921, providing that the basis of "property, acquired by gift" shall be the same as it would be in the hands of the donor, apply?

In No. 873. If the proper basis is cost to the grantor of the trust, is such profit a "capital gain" derived from property "held" for more than two years within the meaning of Sec. 206(a) (6) of the Revenue Act of 1921, and therefore taxable at the capital gain rate of 12½%, or is such profit an ordinary gain and taxable at the normal and surtax rates?

Statutes Involved

These will be found in the Appendix, *infra*, page 27, *et seq.*

Statement

On April 27, 1906, Conrad Henry Matthiessen acquired 6,000 shares of common stock of Corn Products Refining Company at a cost of $141,375, which exceeded value on March 1, 1913 (R., f. 61).

On December 24, 1921, Matthiessen transferred the stock, irrevocably, to The New York Trust Company, in trust for his son, Erard A. Matthiessen, with remainders over in case of the death of the son. (R., ff. 61, 62. A copy of the trust indenture appears at R., pp. 6-8.)

On December 24, 1921, the stock had a fair market value of $577,500 (R., f. 62).

In 1922 the Trust Company sold the stock for $603,385 (R., f. 62).

In computing taxable profit the Commissioner used as a basis the cost of the stock to the grantor of the trust, and determined that such profit was taxable at the normal and surtax rates and was not taxable at the 12½% rate prescribed for "capital gain" (R., f. 62).

The Board of Tax Appeals sustained the Commissioner. The Circuit Court affirmed the Board as to basis but reversed the Board on the other point, holding that the profit was taxable as a capital net gain and not as ordinary income.

The decision as to capital gain conflicted with decisions of the Third Circuit and the Court of Appeals of the District of Columbia [*Johnson* v. *Commissioner*, (C. C. A. 3) 52 F. (2) 726; *Shoenberg* v. *Burnet*, (C. A. D. C.) 55 F. (2) 543], and the Commissioner petitioned for certiorari on this point (No. 873). The taxpayer, while opposing the Commissioner's petition, asked for a writ on the basis question (No. 899), if a writ should be granted the Commissioner. The Court granted both petitions and both questions are here for review.

Specification of Errors to be Urged

1. The Circuit Court erred in holding that Sec. 202 (a) (2) applied.

2. The Circuit Court erred in failing to hold that the basis for computing gain was value of the stock at the time it was transferred in trust.

Summary of Argument

As to Basis. The property sold was trust corpus; the seller, the trustee. The statute does not apply because the trustee did not acquire the trust corpus "by gift." The trust was merely an instrumentality for effecting the gifts to the life tenant and remaindermen. They are the donees. The statute would be applicable if they had sold the property given to them. Against the receipt of trust corpus the trustee gives an undertaking which de-

prives him of all benefit therefrom. The property is not a "gift" to him. For present purposes, his position is analogous to that of a bailee, an attorney-in-fact, a custodian, or a nominee, in none of which cases is the transferee a donee. The view that a trustee does not acquire "by gift" within the meaning of Sec. 202(a) (2) has been incorporated in the Revenue Act of 1924 and all subsequent Revenue Acts, and this construction by legislation should be given effect. To apply the statute would conflict with the rule that the trust is a taxpayer separate and distinct from the beneficiaries. The Board of Tax Appeals has not been consistent on this question and earlier decisions to a different effect should be followed. Sec. 202(a) (2) not being applicable, the proper basis is value at the time the stock was transferred in trust.

As to Capital Gain. The basis section and the capital gain section should be read together and the policy of the law and the object of Congress should be given effect. The purpose of the basis provision was to put the donee in the position of his donor. This theory should be applied with consistency; otherwise, the donee will be in a less favorable position than the donor and the object of the law will be defeated *pro tanto.* The purpose of the capital gain section was to induce taxable transactions otherwise prevented by the excessive tax burden resulting from applying graduated rates to a profit representing an appreciation over a period of years. Hence, it must have been the intention of Congress to measure the period by reference to the time the gain accrued. That view best

promotes the end desired. The change in the 1926 Act obviating the question was interpretative. The purpose and policy of the law leads to that conclusion. The change is stated in the interpretative form. It appears from the Committee Reports on the 1926 Act that the change was considered interpretative as to non-taxable exchanges and distributions. It approved Treasury Department Regulations in those cases. The Reports indicate and it is only reasonable to assume that the concurrent change as to gifts was made for the same purpose. The terms of the statute in fact are not clear and the word "held" must be interpreted in any case. In that event, it should be interpreted in a way consistent with the policy of the law, and not in a way which would defeat its purpose and impose an unintended burden. The adoption of the 1924 Act without change and after a short lived interpretation of this provision by the Treasury Department did not constitute legislative recognition of that interpretation. There is no indication that Congress considered the matter before the passage of the 1924 Act. The decisions cited by the Commissioner do not support his position, whereas there are many decisions of this Court which do support the taxpayer's position.

ARGUMENT

I

Section 202(a) (2) does not apply, and the basis for computing profit is value of the stock at the time it was transferred in trust.

A. The statute does not apply to a sale by the trustee of property transferred in trust.

The issue is whether the "property" sold, the "basis" of which is to be determined, was acquired by the seller "by gift." The property sold was trust corpus; the seller was the trustee. We submit the statute does not apply because the *trustee* did not acquire the *trust corpus* "by gift."

Upon the creation of a trust a number of different property rights are created, the sale of any one of which will be recognized for income tax purposes. The trustee acquires legal title to the trust corpus; the life tenant and remainderman acquire a life estate and a remainder interest. If the trustee sells trust corpus, the trust realizes gain or loss from the sale of that property (*Anderson* v. *Wilson,* 289 U. S. 20); if the life tenant sells his life estate,[1] the life tenant realizes gain or loss from the sale of that property [see *Commissioner* v. *Marshall Field,* (C. C. A. 2) 42 F. (2) 820; *Young* v. *Gnichtel,* (D. C., N. J.)

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[1] As he can do unless forbidden by the trust instrument or by statute. *Croxall* v. *Shererd,* 5 Wall. 268, 281; *Doe* v. *Laming,* 2 Burrow, 1109; *Walton* v. *Walton,* 7 Johnson's Chancery, 270; *Merchants' Loan & Trust Co.* v. *Patterson,* 308 Ill. 519, 139 N. E. 912, 916; 1 Perry on Trusts, Sec. 321, 827a. Cf. N. Y. Personal Property Law, Sec. 15, Laws 1909, c. 45.

28 F. (2) 789; *O'Malley-Keyes* v. *Eaton,* (D. C., Conn.) 24 F. (2) 436]; similarly, if a remainderman sells his remainder interest (*Elfreth,* 15 B. T. A. 147, petition for review dismissed without opinion by C. C. A. 8, April 5, 1932).

The situation may be compared to a corporation and its stockholders. The stock represents merely the beneficial interest in the corporate assets, yet a sale of corporate assets means gain or loss to the corporation; a sale of stock means gain or loss to the stockholder. Where stock is issued for assets, the stock may have a different basis to the stockholder than the assets to the corporation, depending upon the statutory bases prescribed.[2]

The beneficiaries acquire their interests "by gift," but the trustee does not so acquire the trust corpus (*Burnet* v. *Guggenheim,* 288 U. S. 280, 286). The word "gift" connotes a transfer made to confer a gratuitous benefit on the transferee.[3] Upon the creation of a trust the things given

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[2] Under Sec. 202(c) (3) and 202(d) (1) of the Revenue Act of 1921, c. 136, 42 Stat. 230, when assets were transferred to a corporation in exchange for its stock the stock received took the same basis as the assets transferred. However, the corporation acquired a new basis for the assets of value of its stock issued for the property. *Unaka & City National Bank* v. *U. S.,* (C. C. A. 6) 50 F. (2) 1031, certiorari denied, 284 U. S. 645; *Mead Realty Co.,* 21 B. T. A. 1062.

[3] *Bass* v. *Hawley,* (C. C. A. 5) 62 F. (2) 721, 723; *Noel* v. *Parrott,* (C. C. A. 4) 15 F. (2) 669, 671; *Forsyth* v. *Reynolds,* 15 How. 358, 365; *Blair* v. *Rosseter,* (C. C. A. 9) 33 F. (2) 286; *Schumacher* v. *U. S.,* (Ct. Cl.) 55 F. (2) 1007, 1011; *McKenzie* v. *Harrison,* 120 N. Y. 260, 265; *Ingram* v. *Colgan,* 106 Cal. 113, 38 Pac. 315; *Kirchner* v. *Lenz,* 114 Ia. 527, 87 N. W. 497; *Martin* v. *Martin,* 202 Ill. 382, 67 N. E. 1, 3; Webster's New International Dictionary.

are a life estate and/or remainder. The two estates include every beneficial interest. The trust is merely a device, an instrumentality, for effecting these gifts. The life tenant and remainderman are the only donees.[4] The transfer to the trustee is made in consideration of his undertaking to administer the property for the benefit of another.[5] While in the ordinary sense the trustee does not pay anything for the transfer to him, the assurances which he gives offset the value of the property received. In this respect a trust is like a bailment, a power of attorney, a custodianship, and a nominee relationship. In none of such cases is the transferee a donee. While such an undertaking ordinarily runs in favor of the transferor and not, as here, in favor of third parties, this would seem irrelevant. In each case the transferee gets no beneficial interest in the property because of the undertaking which he gives against the receipt of the property. The identity of the party for whose benefit he gives that undertaking is immaterial.

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[4] This view and this statement of the matter has been repeatedly recognized in the cases. See *Moore* v. *Tiller*, (C. C. A. 5) 61 F. (2) 478, 479; *Cazallis* v. *Ingraham*, 110 Atl. (Me.) 359, 360; *Gannon* v. *McGuire*, 47 N. Y. Supp. 870, 872; *Littig* v. *Vestry*, 61 Atl. (Md.) 635, 636.

[5] Compare the language of the trust instrument here (R., f. 12): "Now, therefore, in consideration of the premises and of the mutual covenants and agreements hereinafter set forth and for and in consideration of the sum of ten dollars ($10) by each of the parties hereto to the other in hand paid, the grantor has sold, assigned, transferred, and conveyed unto the trustee and, by these presents, does sell, assign, transfer and convey unto the trustee, six thousand shares of the common stock of Corn Products Refining Company * * *."

Suppose property is transferred to trustees under a Massachusetts trust. The transferors receive trust certificates in exchange. Clearly, there is no gift to anyone. Suppose, however, that thereafter a trust certificate is voluntarily transferred without consideration. That, clearly, is a gift of the rights represented by the certificate, but not a gift of the property transferred in trust. Suppose a grantor, who is entitled to a certificate by virtue of his contribution, directs that his certificate in the first instance be issued to another, who pays nothing therefor. That also clearly is a gift of the certificate to the recipient thereof, but this likewise involves no gift of the property acquired by the trustees. It would seem this latter situation differs from this case, for present purposes, only in the fact that here there is no trust certificate. Surely such a difference is not a distinction.[6]

It is of no consequence that upon the creation of the trust the grantor made a gift of life and remainder interests to the life tenant and remainderman. They are not the taxpayers here, and the property which was given to them was not sold. The fact that a gift is involved would be relevant only if the statute read: "In the case of property acquired in connection with or as a result of a transfer by gift of other property to someone else." Such an idea is not within the meaning of the language used.

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[6] In an action in trover for conversion of the trust certificate the measure of damage would be the reasonable value of the *chose in action*, and not the value of the parchment or paper. *Mercer* v. *Jones*, 3 Camp. N. P. 477; *Hazewell* v. *Coursen*, 13 Jones & Sp. 22; *Bavins* v. *London etc. Bank*, 1 Q. B. 270.

The statute looks to the status of the transferee of the particular property sold.

For these reasons, we submit, *Burnet* v. *Guggenheim*, 288 U. S. 280, does not support the Commissioner here. It merely held that the relinquishment of a power to revoke a revocable trust was a taxable gift. Neither the identity of the donee nor the subject matter of the gift was in issue. If a grantor creates a trust and reserves a life estate, the subject of the gift is a remainder interest, and the gift tax is computed on the basis of the value of the remainder interest, not on the basis of the value of the trust corpus.[7] The trust corpus is not given to the donee, that is, the remainderman; nor is there any "gift" of the corpus to the trustee.[8]

The view that a trustee does not acquire "by gift" has been incorporated in the Revenue Act of 1924 and in all subsequent Revenue Acts. When the 1924 Act was passed it continued without change the provisions of the 1921 Act as to gifts (Appendix, p. 28), but immediately following there was inserted this new provision:

> "(3) If the property was acquired after December 31, 1920 by a transfer in trust (other than by

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[7] How could basis be determined by applying Sec. 202(a) (2) to this situation? The entire beneficial interest in the property sold is not acquired by anyone "by gift." Should the trustee in calculating his basis adopt some method of apportionment and, if so, on what authority?

[8] Art. 21, Regulations 79, pertaining to the gift tax imposed by the Revenue Act of 1932, requires the filing of an information return by the transferee. The form (Treasury Department Form No. 710) is headed: "Donee's or Trustee's Information Return of Gifts."

a transfer in trust by bequest or devise) the basis shall be the same as it would be in the hands of the grantor, * * *;"

This was followed by the provision:

"(4) If the property was acquired by gift *or* transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition." (Italics ours)[9]

The House Ways and Means Committee reported with respect to the change:[10]

"There is no provision in the existing law which corresponds to paragraph (3). This paragraph applies the same principles to transfers to a trustee as is applied in paragraph (2) to gifts."

The Senate Finance Committee likewise explained:[11]

"There is no provision in the existing law which corresponds to paragraph (3) of subdivision (a). According to this paragraph, the basis for determining gain or loss from the sale or other disposition of property acquired after December 31, 1920, by a voluntary transfer in trust, is the same as it would be in the hands of the grantor, following the principle laid down in paragraph (2) as to gifts."

In all Revenue Acts subsequent to the 1924 Act this distinction between "gifts" and "transfers in trust" has been

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[9] 1924 Act, Sec. 204(a) (3), (4); c. 234, 43 Stat. 258. The complete sections will be found in the Appendix, pp. 28, 29.

[10] House Report No. 179, 68th Congress, 1st Session, p. 16.

[11] Senate Report No. 398, 68th Congress, 1st Session, p. 17.

carefully preserved.[12] Such legislative history and statutory arrangement evidence an intention not to apply Sec. 202 (a) (2) to trustees. We submit this intention should be given effect.

The Circuit Court, despite the Committee reports above quoted, took the view (R., f. 81) that the change in the 1924 Act was "a definition of earlier purpose." Where the effect of a provision of a revenue statute is to impose a burden, the presumption is to the contrary (*Shwab* v. *Doyle,* 258 U. S. 529; *Lewellyn* v. *Frick,* 268 U. S. 238).

The Circuit Court, finding that "the transaction as a whole could not be less" than a gift (R., f. 80), concluded that the statute applied. Such an approach ignores the identity of the property sold, ignores the separate existence of the trustee and *cestuis que trustent,* and, we submit, is inconsistent with the well established rule that a trust is to be treated for income tax purposes as a taxpayer wholly separate and distinct from the beneficiaries [*Anderson* v. *Wilson,* 289 U. S. 20; *Busch* v. *Commissioner,* (C. C. A. 5) 50 F. (2) 800; *Baltzell* v. *Mitchell,* (C. C. A. 1) 3 F. (2) 428, certiorari denied, 268 U. S. 690; *Roxburghe* v. *Burnet,* (C. A. D. C.) 58 F. (2) 693, certiorari denied, 286 U. S. 567]. The trust and *cestuis que trustent* together do not constitute a unit and for no income tax purpose are they considered such. Their separateness has been rigidly observed wherever their status has been at issue.

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[12] 1926 Act, Sec. 204(a) (2), (3) and (4), c. 27, 44 Stat. 14; 1928 Act, Sec. 113(a) (2), (3) and (4), c. 852, 45 Stat. 818, 819; 1932 Act, Sec. 113(a) (2), (3) and (4), c. 209, 47 Stat. 198, 199; 1934 Act, Sec. 113(a) (2), (3) and (4).

The Circuit Court was influenced by its conclusion that the purpose of Sec. 202(a) (2) "demanded that such a transaction as this be included" (R., f. 80). However, an omitted taxable subject cannot be reached by invoking a general intention (*Smietanka* v. *First Trust & Savings Bank*, 257 U. S. 602, 606, 607; cf. *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509). Also, taxing statutes are not to be enlarged "to embrace matters, not specifically pointed out, although standing upon a close analogy" (*United States* v. *Wigglesworth*, 2 Story 369, 373, 374), and are to be construed liberally in favor of the taxpayer and most strongly against the Government (*Bowers* v. *New York and Albany Lighterage Company*, 273 U. S. 346; *Crooks* v. *Harrelson*, 282 U. S. 55; *Gould* v. *Gould*, 245 U. S. 151; *Partington* v. *Attorney-General*, L. R. 4 H. L. 100, 122).

Before the Board of Tax Appeals rendered its decision in this case it decided two other cases (*Bankers Trust Company, Trustee*, 24 B. T. A. 10; *Francis Francis*, 15 B. T. A. 1332) bearing on this question. The decision in the *Bankers Trust Company* case would seem directly in conflict with the Board's decision here. The views expressed in the *Francis Francis* case also support the taxpayer's contentions here. So far as we have been able to ascertain there have been no other cases involving the issue.

B. The basis is value at the time the stock was transferred in trust.

If Section 202 (a) (2) is not applicable, there is no provision in the Revenue Act of 1921 prescribing the basis

of a trustee, unless it be the general provision [Section 202 (a)] that the basis shall be "cost." It is well established that, under such circumstances, the basis to be used is value at the time acquired by the taxpayer. *Heiner* v. *Tindle*, 276 U. S. 582; *Brewster* v. *Gage*, 280 U. S. 327 (insofar as it involved the 1918 Revenue Act); *Rice* v. *Eisner*, (C. C. A. 2) 16 F. (2) 358, certiorari denied, 273 U. S. 764; *Lucas* v. *Daniel*, (C. C. A. 5) 45 F. (2) 58; *Matthiessen* v. *United States*, 65 Ct. Cl. 484, certiorari denied, 278 U. S. 609; *Bankers Trust*, 24 B. T. A. 10; *Francis*, 15 B. T. A. 1332; *Harris*, 14 B. T. A. 1259; *Brunton*, 15 B. T. A. 727; *Hewett*, 14 B. T. A. 281.

II

If Section 202(a) (2) is applicable the gain is taxable as a capital gain under Section 206.

This question arises only if the first point is decided adversely to the taxpayer. If a new basis was established upon the creation of the trust, admittedly there commenced a new tenure for purposes of capital gain.

The statutory provision to be construed defines "capital assets" as

> "property acquired and held by the taxpayer for profit or investment for more than two years * * *." Sec. 206(a) (6)

In interpreting this provision we ask the Court to apply the principles expressed in the following quotation from

the opinion of Mr. Chief Justice Taney in *Brown* v. *Duchesne,* 19 How. 183, 194:

> "The general words * * *, taken by themselves, and literally construed, without regard to the object in view, would seem to sanction the claim of the plaintiff. But this mode of expounding a statute has never been adopted by any enlightened tribunal—because it is evident that in many cases it would defeat the object which the Legislature intended to accomplish. And it is well settled that, in interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the Legislature, as thus ascertained, according to its true intent and meaning."

A proper construction of the capital gain provision requires consideration not only of its purpose and design, but also of the objects and policy of the basis provision. The two sections must be read together in order to give effect to the will of the Legislature and in order not to defeat its object.

In *Taft* v. *Bowers,* 278 U. S. 470, the Court analyzed the relationship between donor and donee which had been established by the basis provision, and found that "as to the property received" the donee "assumed the position of her donor" (p. 482), and Congress had required that

> "for purposes of taxation the donee should accept the position of the donor in respect of the thing received." (p. 483)

As Judge Learned Hand said, in the view of the basis section the acceptance of the gift by the donee "is regarded as a vicarious substitution of himself for the donor" (R., p. 41).

If the trustee is substituted for the grantor for purposes of basis, he should be substituted likewise for purposes of tenure. If Sec. 202(a) (2) is applicable at all, its theory should be applied with consistency. Otherwise, the donee is put in a less favorable position than the donor, and the obvious intention of Congress to put the donee in the same position as the donor in respect of the property is defeated *pro tanto*.[13] Statutes are to be so construed that one section will not defeat another (*Bernier* v. *Bernier*, 147 U. S. 242); and laws in respect of the intensely practical matter of taxation should be applied with a view to avoiding unjust and oppressive consequences (*Farmers Loan & Trust Co.* v. *Minnesota*, 280 U. S. 204, 212).

In asking the court to look to Sec. 202 in interpreting Sec. 206, we believe we ask it to do no more than it did in *Burnet* v. *Guggenheim*, 288 U. S. 280, 286, where it referred to the provisions of the estate tax law as an aid in construing the gift tax law.

Turning next to Sec. 206, we find these provisions were adopted to relieve the taxpayer from excessive tax burdens

[13] For example, if the grantor in the present case had sold the stock and put the proceeds in trust, thereby arriving at the same result as that accomplished, the grantor would have paid a maximum tax with respect to the transaction of $57,751.25, that is, 12½% of the difference between cost to the grantor and selling price. By taxing the trustee on the appreciation of sixteen years at the normal and surtax rates the Commissioner is claiming a tax of $251,497.40, or over 54% of the difference between cost to the grantor and selling price.

on gains resulting from conversion in one year of capital investments which had appreciated in value over a period of years, and to remove the deterrent effect of these burdens on such conversions, the Government thereby realizing more revenue than otherwise [*Burnet* v. *Harmel,* 287 U. S. 103, 106; *Alexander* v. *King,* (C. C. A. 10) 46 F. (2) 235, 236; House Rep. No. 350, 67th Congress, 1st Session, p. 10]. In that case the purpose of the law is best promoted by measuring the two-year period by reference to the time during which the untaxed gain accrued rather than by the time when the property was in the possession of the taxpayer. Unquestionably, Congress would have specifically so provided (as it did in the 1926 and later Acts) had it considered the matter, but

> "This is not to say that meaning has been lost because extraordinary foresight would have served to make it clearer." *Burnet* v. *Guggenheim, supra,* p. 288.

Burnet v. *Harmel,* 287 U. S. 103, affords substantial support for the taxpayer's contentions. The bonus payments were the proceeds of the "sale" of oil and gas in place under Texas law, but the transaction was not considered a "sale" within the meaning of Section 206, because, among other reasons, the transaction "did not produce the kind of hardship aimed at" (p. 106), and a contrary construction "would have tended to defeat rather than further the purpose of the Act" (p. 108). While the situation was the converse of that here, the considerations to which the Court attached importance apply with equal force.

Sec. 206 was continued without material change in Sec. 208 of the Revenue Act of 1924, c. 234, 43 Stat. 263. In the Revenue Act of 1926, however, the corresponding provision [Sec. 208(a) (8)] was amplified to obviate the present question. The statute will be found in full in the Appendix, page 32.[14] We submit the amplified provisions of the 1926 Act are interpretative and not legislative.

The balance would seem definitely in favor of this view. Having in mind the purpose and policy of the law this is the logical inference (cf. *Burnet* v. *Guggenheim, supra,* in respect to the view taken of the specific provision of the 1932 Gift Tax Law). The statutory arrangement and phraseology support that conclusion. The first sentence of Sec. 208(a) (8) of the 1926 Act is practically the same as the statute in question. They are *in pari materia.* What follows the 1926 provision is in the interpretative form. Being interpretative of the general provision of the 1926 Act it should be taken as interpretative of the corresponding provision of the 1921 Act.

The history of the 1926 provision leaves no doubt as to its interpretative character. It will be noted that three types of cases are enumerated where actual possession by the taxpayer for more than two years is not necessary:

1. Where the property was exchanged for other property without a change in basis.

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[14] The definition of "capital assets" in Section 208(a) (8) of the 1926 Act was continued without material change in the later Revenue Acts which contained the "capital gain" provisions. 1928 Act, Sec. 101(c) (8), c. 852, 45 Stat. 811; 1932 Act, Sec. 101(c) (8), c. 209, 47 Stat. 192. Cf. 1934 Act, Sec. 117(c) (2).

2. Where the property was acquired from another person without a change in basis.

3. Where the property was received upon a capital distribution without recognition of gain or loss.

Before the passage of the 1926 Act the Treasury Department had already taken the same position with respect to cases 1 and 3 [Art. 1651, Reg. 62 (1921 Act) and Reg. 65 (1924 Act)]. Apparently there was some doubt as to whether the Regulations were sound. When the question was presented to Congress it approved the interpretation of the Treasury Department and went further and said that the same applied to property acquired by gift. The statement of the Committees on the change is set forth in the margin.[15]

[15] House Rep. No. 1 and Senate Rep. No. 52, 69th Congress, 1st Session:

"Section 208 (a) (8). The 12½ per cent capital gain and loss provisions apply only to the sale or exchange of capital assets which have been held by the taxpayer for two years. Under the reorganization provisions many transactions are exempt from tax until the stockholder disposes of his stock received as a result of the reorganization. As a result of this fact *the question frequently arises* as to whether the period that the taxpayer held the stock which he exchanged for new stock should be added to the period for which he held his new stock in order to determine whether or not he has held it for two years. The amendment proposed to this section *incorporates in the law the present regulation of the Treasury* and provides that these two periods shall be added for the purpose of determining the period during which the property sold was held for the purpose of determining both gain and loss under this section. *The same question arises in the case of property received by gift after December 31, 1920.* The amendment provides that the period in which the property was held by the donor shall be added to the period in which the property was held by the donee in determining whether or not the property so received falls within the capital gain or loss section.". (Italics ours)

There is nothing to indicate that, as to *exchanges,* the new provisions are interpretative and, as to *gifts,* prospectively legislative. We submit that the Congressional Committee Reports show that Congress was dealing with two questions of interpretation, first, whether a non-taxable exchange tolled the two-year period, and, second, "the same question * * * in the case of property received by gift after December 31, 1920." In both cases the function of the later statute, according to the draftsmen of the law, was intended to be interpretative.[16]

The Commissioner's principal argument is that the terms of the statute are so clear they allow no room for construction. The assumption of clarity is unfounded. The word "held" suggests many conceptions. Presumably, the Commissioner does not have in mind a physical clutching. Also, it is doubted if he means dominion, since that view was rejected in I. T. 1889, III-1 Cum. Bull. 70, and the Commissioner cites the ruling here. It is believed he claims, impliedly, that "held" as used here is synonymous with "title," a conception which becomes less and less important as we go along (*Corliss* v. *Bowers,* 281

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[16] The Commissioner tries to distinguish the effect of the subsequent legislation as to basis from the effect of the subsequent legislation as to capital gain on the ground that in the former case the later statute "merely enacted into law the administrative interpretation of the earlier statute," whereas in the latter case "the change in the statute is contrary to the administrative construction of the prior law." When it is noted that, as to capital gain, the later statute in respect to non-taxable exchanges and distributions "merely enacted into law the administrative interpretation of the earlier statute" the distinction loses whatever significance it otherwise might have.

U. S. 376; *Burnet* v. *Guggenheim, supra; Burnet* v. *Wells,* 289 U. S. 670). But by interpreting "held" as "title" the Commissioner is engaged in the very process of construction which he asks the Court to ignore.

As long as the word "held" must be interpreted in any case, we submit it should interpreted in a way consistent with the policy of the law, and not in a way which would defeat its purpose and impose an unintended burden.

We may well believe that Mr. Justice Swayne, who wrote the opinion in *United States* v. *Hartwell,* 6 Wall. 385, cited by the Commissioner, would be among the first to reject his contention. There is set forth in the margin that portion of the opinion (pp. 395, 396) from which the Commissioner has selected two short sentences.[17] Also, in *Ruggles* v. *Illinois,* 108 U. S. 526, and *Lake County* v. *Rollins,* 130 U. S. 662, cited by the Commissioner, the Court was careful to state that terms

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[17] "We are not unmindful that penal laws are to be construed strictly. It is said that this rule is almost as old as construction itself. But whenever invoked it comes attended with qualifications and other rules no less important. It is by the light which each contributes that the judgment of the court is to be made up. The object in construing penal, as well as other statutes, is to ascertain the *legislative intent. That constitutes the law.* If the language be clear it is conclusive. There can be no construction where there is nothing to construe. The words must not be narrowed to the exclusion of what the legislature intended to embrace; but that intention must be gathered from the words, and they must be such as to leave no room for a reasonable doubt upon the subject. It must not be defeated by a forced and over-strict construction. *The rule does not exclude the application of common sense to the terms made use of in the*

are to be followed literally only if the words convey a definite meaning and the result involves no absurdity nor inconsistency with other provisions. As we read the other authorities cited by the Commissioner, they do not purport to reject the principles relied upon here.

Those principles recently have been applied in a number of cases besides *Burnet* v. *Harmel, supra.*

In *Brewster* v. *Gage,* 280 U. S. 327, the question was when a residuary legatee "acquired" the property sold, as that term was used in the section prescribing basis. The Court held the legatee "acquired" the property at the time of death. Admittedly, the legatee did not then come into possession or take legal title. The Court relied upon the facts that the legislative history did not indicate a *purpose* to establish different bases for specific and general bequests, and that it was *unreasonable* to calculate gains or losses to the estate on one basis and those to the residuary legatee on another.

In *Pinellas Ice & Cold Storage Company* v. *Commissioner,* 287 U. S. 462, the statute described a non-taxable

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act in order to avoid an absurdity, which the legislature ought not to be presumed to have intended. When the words are general and included various classes of persons, there is no authority which would justify a court in restricting them to one class and excluding others, where the purpose of the statute is alike applicable to all. *The proper course in all cases is to adopt that sense of the words which best harmonizes with the context, and promotes in the fullest manner the policy and objects of the legislature.*" The rule of strict construction is not violated by permitting the words of the statute to have their full meaning, or the more extended of two meanings, as the wider popular instead of the more narrow technical one; *but the words should be taken in such a sense, bent neither one way nor the other, as will best manifest the legislative intent.*" (Italics ours)

reorganization as including "the acquisition by one corporation of * * * substantially all the properties of another corporation." The Court found that, looking to the *purpose* of the statute, this provision did not include a sale by one corporation of all of its assets to another although, literally, the terms covered that case. See also *Cortland Specialty Co.* v. *Commissioner,* (C. C. A. 2) 60 F. (2) 937, certiorari denied, 288 U. S. 599.

In *Burnet* v. *Guggenheim, supra,* the Court placed great reliance on the unreasonableness in practical effect of a view contrary to that which it adopted, while the Second Circuit [58 F. (2) 188], which decided the present case, thought the meaning there so clear as to preclude resort to such aids to construction.

The Commissioner claims that the view adopted in I. T. 1379, I-2 Cum. Bull. 41, and I. T. 1660, II-1 Cum. Bull. 36[18] received legislative sanction by the enactment of the 1924 Act without change. The first ruling was promulgated in July, 1922, and the 1924 Act was approved June 2, 1924, c. 234, 43 Stat. 253. The interval of less than two years would scarcely seem the long period of executive construction referred to in *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, and *Brewster* v. *Gage,* 280 U. S. 327, relied upon by the Commissioner. In *Merritt* v. *Cameron,* 137 U. S. 542, 552, the Court said that a construction of a statute by the executive department charged with its execution is not binding upon the

[18] The Commissioner also cites I. T. 1889, III-1 Cum. Bull. 70, but the views expressed there would seem more favorable to the taxpayer than they are to the Commissioner.

courts "unless such construction has been continuously in force for a long time."

A careful examination of the records of the consideration of the 1924 Revenue Act before passage fails to indicate that the situation was brought to the attention of Congress. There is nothing on the subject either in the Committee Reports,[19] or in the reports of the hearings,[20] or in the Congressional Record covering the debate.[21]

The Commissioner relies upon the line of cases represented by *Darby-Lynde Co.* v. *Commissioner,* (C. C. A. 10) 51 F. (2) 32. If resort is to be had to analogies, we submit a closer one is that represented by the cases of *United States* v. *Kauffmann,* (C. C. A. 9) 52 F. (2) 1045, and *Commissioner* v. *Sansome,* (C. C. A. 2) 60 F. (2) 931, certiorari denied, 287 U. S. 667. In those cases the courts held that a non-taxable reorganization of a corporation did not change accumulated surplus into capital, and that distributions by the reorganized company constituted "dividends" within the meaning of the income tax law. In reaching this conclusion the courts construed the reorganization provisions and the dividend provisions together and decided that what was not recognized as a disposition for purposes of fixing gain or loss

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[19] House Rep. No. 179, Senate Rep. No. 398, 68th Cong., 1st Session.

[20] Hearings Before the Ways & Means Committee, 68th Cong., 1st Session, on H. R. 6715, January 14-19, 1924. Hearings Before the Senate Finance Committee, March 7–April 8, 1924.

[21] Congressional Record, vol. 65, February 14-16, 18-23, 25, 28, 29, 1924 (House); April 24, 25, 28-30, May 1-3, 5-10, 1924 (Senate).

should not be recognized as changing accumulated profits into capital. The decisions upheld the Commissioner.

For these reasons, if the first point is decided against the taxpayer, the capital gain section should be construed in its favor. Otherwise, the purpose of the law will be defeated and the result, contrary to the intention of Congress, will be extremely harsh. The terms of the statute do not preclude the Court from giving effect to its object and policy.

Conclusion

The decision of the Circuit Court of Appeals on the first issue should be reversed, but if affirmed, its decision on the second issue should likewise be affirmed.

Respectfully submitted,

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May 1934.

APPENDIX

Containing Statutes Involved

As to Basis

Revenue Act of 1921; c. 136, 42 Stat. 229.

Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

(1) In the case of such property, which should be included in the inventory, the basis shall be the last inventory value thereof;

(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition;

Revenue Act of 1924; c. 244, 43 Stat. 258.

Sec. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

(1) If the property should have been included in the last inventory, the basis shall be the last inventory value thereof;

(2) If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. The provisions of this paragraph shall not apply to the acquisition of such property interests as are specified in subdivision (c) or

(e) of section 402 of the Revenue Act of 1921 or in subdivision (c), (d), or (f) of section 302 of this Act;

(4) If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition;

AS TO CAPITAL GAIN

Revenue Act of 1921; c. 136, 42 Stat. 232, 233.

Sec. 206. (a) That for the purpose of this title:

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

(2) The term "capital loss" means deductible loss resulting from the sale or exchange of capital assets consummated after December 31, 1921;

(3) The term "capital deductions" means such deductions as are allowed under this title for the purpose of computing net income and are properly allocable to or chargeable against items of capital gain as defined in this section.

(4) The term "capital net gain" means the excess of the total amount of capital gain over the sum of capital deductions and capital losses;

(5) The term "ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions; and

(6) The term "capital assets" as used in this section means property acquired and held by the tax-

payer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(b) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain; but if the taxpayer elects to be taxed under this section the total tax shall in no such case be less than 12½ per centum of the total net income. The total tax thus determined shall be computed, collected and paid in the same manner, at the same time and subject to the same provisions of law, including penalties, as other taxes under this title.

(c) In the case of a partnership or of an estate or trust, the proper part of each share of the net income which consists, respectively, of ordinary net income and capital net gain, shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the

partnership or estate or trust, and shall be taxed to the member or beneficiary or to the estate or trust as provided in sections 218 and 219, but at the rates and in the manner provided in subdivision (b) of this section.

Revenue Act of 1926; c. 27, 44 Stat. 19, 20.

Sec. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

(2) The term "capital loss" means deductible loss resulting from the sale or exchange of capital assets;

(3) The term "capital deductions" means such deductions as are allowed by section 214 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year;

(4) The term "ordinary deductions" means the deductions allowed by section 214 other than capital losses and capital deductions;

(5) The term "capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain;

(6) The term "capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain;

(7) The term "ordinary net income" means the net income, computed in accordance with the provi-

sions of this title, after excluding all items of capital gain, capital loss, and capital deductions; and

(8) The term "capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 204 the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged. In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 204 such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person. In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of subdivision (c) of section 203 of this Act or of the Revenue Act of 1924, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(b) in the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(c) In the case of any taxpayer (other than a corporation) who for any taxable year sustains a capital net loss, there shall be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax under this subdivision be less than the taxes imposed by sections 210 and 211 computed without regard to the provisions of this section.

(d) The total tax determined under subdivision (b) or (c) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

(e) In the case of the members of a partnership, of an estate or trust, or of the beneficiary of an estate or trust, the proper part of each share of the

net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership or estate or trust, and shall be taxed to the member or beneficiary or to the estate or trust as provided in sections 218 and 219, but at the rates and in the manner provided in subdivision (b) or (c) of this section.